

Testimony of the  
National Association of Insurance Commissioners

Before the  
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Regarding:  
“Increasing the Effectiveness of State  
Consumer Protections”

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## **Testimony of Joel Ario, Secretary-Treasurer National Association of Insurance Commissioners**

### **Introduction**

My name is Joel Ario. I am the Insurance Administrator for the State of Oregon, and this year I am serving as Secretary-Treasurer of the National Association of Insurance Commissioners (NAIC). In addition, I serve as Chair of the NAIC's Market Regulation & Consumer Affairs Committee. I am pleased to be here on behalf of the NAIC and its members to provide the Subcommittee on Oversight and Investigations with an update of our efforts to modernize market regulation of insurers and agents to make that regulation both more effective and more efficient.

Let me start by observing that effective consumer protection focused on local needs is the hallmark of state insurance regulation. The preface to the Oregon Insurance Code states that the Code is to be "liberally construed for the benefit of the insurance buying public." I take that mission very seriously, as do other state insurance regulators, because we recognize that protecting consumers is the real purpose for government regulation of insurers and agents. We understand America's varied blend of local and regional markets, as well as the needs of consumers in these markets. Meaningful evaluation of proposals to improve the state regulatory system must begin with a hard look at their impact on consumer protection.

This focus on consumer protection does not in any way mean that state insurance regulators are not concerned with efficiency in carrying out our regulatory responsibilities. In fact, it is clear that a healthy, competitive industry is vital for consumers since the worst case scenario for consumers is to have no insurers available to meet their insurance needs. Inefficient and burdensome regulation is bad for insurers, and it also is bad for consumers. That is why our modernization program focuses on both effectiveness and efficiency.

Building on this framework, I would like to make three points today.

- **First, NAIC and the states are well underway in our efforts to modernize state market regulation.** In some areas, our goal is to achieve national uniformity because it makes sense for both consumers and insurers. In areas where state differences are justified because they reflect local or regional needs, we are harmonizing state regulatory procedures to ease compliance by insurers and agents doing business in those markets. As you might guess, there are some tough judgment calls as to when uniformity or at least reciprocity makes sense, versus when differences should be respected and preserved as appropriate responses to local needs. But we are engaged in the process and we are making progress as I will discuss today.
- **Second, market regulation is more difficult to harmonize than financial regulation.** On the financial side, NAIC and the states have developed an effective accreditation system that is built on the concept of domiciliary deference (i.e., the state where the insurer is domiciled takes the lead role). This makes eminent sense because financial records do not change state to state; if one state has reviewed financial records and determined a company to be in good standing, it would truly be redundant for another state to review those same records. On the market side, it is not as straightforward. The market behaviors of insurers can be quite different from one state to another, both because the laws may be different and because insurer compliance with the laws may vary by state. In short, market regulation is definitely not an area where “one size fits all” across the country.
- **Third, the balance between uniformity and state diversity varies by line of insurance.** Life insurers have made a strong case for uniformity in product review standards, partly on the basis that the underlying financial risk that they insure does not vary by state and therefore product standards should not vary. Property and casualty insurers have not made the same case, because they recognize that the underlying risks they insure do vary by state. An urban state has different risks in its auto market than a rural one, Florida has different catastrophe risks than Kansas, and

so on. Health markets also differ markedly by state given that health costs depend on variables such as hospital and provider networks, and population demographics. In this context, our modernization work has struck different balances in different lines of insurance.

## **Protecting Consumers is the First Priority of State Insurance Regulation**

Government regulation of insurance companies and agents began in the states well over 100 years ago for one overriding reason – to protect consumers. Our most important consumer protection responsibility is to assure that insurers remain solvent so they can meet their obligations to pay claims. But state regulation has always had an equally important second purpose: to ensure that consumers are treated fairly when they purchase insurance products and file claims. Unlike most products, the purchaser of an insurance policy will not be able to fully determine the value of the product purchased until after a claim is presented — when it is too late to decide that a different insurer or a different product might make a better choice.

Paying for insurance products is one of the largest consumer expenditures of any kind for most Americans. Figures compiled by the NAIC show that an average family can easily spend a combined total of \$4,500 each year for auto, home, life, and health insurance coverage. This substantial expenditure – often required by law or business practice – is typically much higher for families with several members, more than one car, or additional property to insure. Consumers clearly have an enormous financial and emotional stake in making sure that the promises made by insurers are kept.

Protecting insurance consumers in a world of hybrid institutions and products must start with a basic understanding that insurance is a different business than banking and securities, with multiple decision points that impact consumer protection concerns: Will an insurance policy be offered to a consumer? At what price? What are the policy terms and conditions? What risks are excluded from coverage? Is a claim filed by a policyholder valid? If so, how much should the customer be paid under the policy terms?

When consumers believe they have been mistreated by insurers, they look to regulators for assistance and there can be significant consumer backlash and customer dissatisfaction absent effective regulatory attention. During 2001, state regulators handled approximately 3.5 million consumer inquiries and complaints regarding the content of their policies or their treatment by insurance companies and agents. Many of those calls led to a successful resolution of the problem at little or no cost to the consumer.

As regulators of insurance, state governments are responsible for responding to the expectations of American consumers – including those who are elderly or low-income – regarding financial safety and fair treatment by insurance companies and agents. State insurance commissioners are the public officials who are appointed or elected to perform this consumer protection function. Nationwide in 2001, we employed 12,300 regulatory personnel and spent \$942 million to be the watchful eyes and helping hands on consumer insurance problems. The states also maintain a system of financial guarantee funds that cover personal losses of consumers in the event of an insurer insolvency. The entire state insurance regulatory system is authorized, funded, and operated at no cost to the federal government.

### **Finding a Regulatory Balance that is Effective and Efficient**

Efforts to improve market regulation must start with the fact that it is multi-faceted, and that the best way to make market regulation both more effective and more efficient is to focus on bringing more coordination to the various facets of regulation. NAIC has identified seven major market regulatory components that are common to all state insurance departments, even if not always defined and organized as separate activities:

- ◆ Consumer complaint handling
- ◆ Producer licensing
- ◆ Rate and form review
- ◆ Market analysis
- ◆ Market conduct examinations

- ◆ Investigations
- ◆ Enforcement

In addition, state insurance departments typically include various other ancillary activities, such as consumer education and outreach, especially to vulnerable populations; oversight of residual markets, and antifraud programs.

It is important to start with this list because many of the efforts to modernize market regulation involve taking an integrated view of how the various market regulation functions can work together, rather than looking at specific functions in isolation. For example, it may not be sensible to simply deregulate the rate and form review process, but it may make a lot of sense to shift some of the focus from “front end” review (the traditional approach) to a combination of self certification and “back end” review through desk exams or other similar approaches. Similarly, it may not be sensible to simply cut the number of market conduct examinations, but it may make a lot of sense to shift some of the focus from on-site, comprehensive examinations to more reliance on less intrusive market analysis techniques that identify outliers and allow for more careful targeting of examinations.

Appendix A to my testimony includes detailed summaries of current NAIC work on each of the seven key market regulatory functions. What I want to focus on here, though, is two broad themes that underlie much of our work to modernize market regulation: market analysis and collaboration among the states.

A central reform currently being pursued through the NAIC is to better define and elevate the importance of market analysis as the most effective regulatory tool for drawing on all of the market regulation functions to target the most serious consumer problems. While much industry criticism focuses on market conduct examinations, they are only one piece of a broader system of state oversight activities that include ongoing information gathering and analysis to spot problems as early as possible and correct them. Market conduct exams are a useful tool, but even if sufficient resources were available to conduct more of them, such exams must be complemented by other regulatory strategies for

addressing problems before they become the kind of business practice that exams typically seek to uncover.

In fact, the most important improvements in market regulation are likely to come from regulators utilizing modern data analysis techniques to identify significant problems early. We believe financial analysis, which complements financial exams by analyzing the current financial condition of significant insurers using real-time data, can serve as the model for making market regulation more timely and effective. There is a broad range of information available for market analysts to use in improving regulatory efficiency.

I note that the Insurance Marketplace Standards Association (IMSA) is represented on today's panel. I want to take a moment to applaud the work of this organization in promoting self audits by life insurance companies. These self audits are not a substitute for regulatory oversight, but they do provide invaluable information that, if shared with regulators, can and should play a significant role in market analysis. Financial analysts routinely review the work of independent auditors to make decisions about regulatory priorities and there is no reason that market analysts can't do the same thing.

Effective use of market analysis techniques, such as enhanced data sharing and interpretation, can also help achieve coordinated state regulatory action with substantially less redundancy and cost. The relationship between market analysis and interstate collaboration is an important one. Effective data collection and analysis can help individual states better target their regulatory resources, but it also can facilitate better collaboration among the states. As states build a common knowledge base and engage in more coordinated monitoring efforts, there will be more opportunities to pursue collaborative enforcement of consumer protection laws. I will discuss some of those collaborative efforts in the next section, but let me first reinforce my earlier comment that the collaborative model on the market regulation side cannot be as easy and simple as the model of domestic deference on the financial side. There clearly are cases where states

can rely on each other, but there also are limits to that reliance rooted in differences in state laws, as well as local variations in company behavior.

The NAIC has been looking carefully at the extent to which one state can rely on the findings of another state when it comes to making regulatory decisions about examinations, investigations, and enforcement actions. We are looking at collaborative models for relying on the domestic state (or some combination of states) for baseline monitoring of companies, and we have several specific collaborative projects underway. But, ultimately, we cannot escape the fact that regulatory violations can affect consumers in different states quite differently. Since regulators are government officials who must enforce the laws of their state, they cannot delegate that responsibility to someone who may not understand or appreciate the nature of a particular violation and its impact on local consumers.

We, therefore, believe it is critical to first recognize the primacy of state consumer protection laws when attempting to increase regulatory coordination. For example, an important complement to states relying on each other for baseline monitoring of companies is the flexibility for states to conduct targeted examinations, investigations, and enforcement actions when there is a specific consumer problem requiring attention. If we do not build in adequate flexibility for a state to protect its citizens under the laws of that state, we would be asking state regulators to ignore their oath of office. In effect, we would be creating a system that would not work and would not have the confidence of the consumers and government officials it is intended to serve.

For example, New York faces unique market problems regarding the price, availability, and administration of terrorism insurance. The Superintendent of Insurance in New York has devoted much effort to making the terrorism insurance market work for consumers in his state. Would New York feel comfortable being forced to accept the findings of another state dealing in a generic way with terrorism exclusions when the problems in New York are unique to the terrorism risks confronting the New York market? Would



another state regulator where the insurer is domiciled really understand the vagaries of the New York market or the nuances of New York law?

Likewise, regulators in Florida and other coastal states will have a special interest in underwriting practices and policy terms for insurance covering hurricane damages. State regulators also will have different views of health underwriting practices based on the dynamics in their local markets. Congress recognized this when it imposed minimum portability requirements on the states, but allowed states to preserve current laws or develop new ones that were tailored to local conditions, as long as the minimum standards were met.

The NAIC and its members have the expertise to handle the tensions between promoting uniform market conduct oversight across the United States while preserving local control over matters that directly affect consumers and policyholders within each state. We believe much progress can be made to achieve the goals of efficiency sought by industry representatives. However, we do not overlook the fact that insurance must be regulated to protect local consumers. Regulatory efficiency for its own sake should not undermine the credibility and effectiveness of the state regulators charged with enforcing consumer protection laws.

### **Update on NAIC's Market Regulation Reform Initiatives**

While recognizing the inherent strength of our state-based system when it comes to protecting consumers, we also agree that there is a need to improve the efficiency of the system. The 2003 NAIC market regulation reform initiatives include market analysis techniques, uniform examination procedures and collaborative regulatory efforts. Let me briefly review the six major initiatives currently being pursued by the Market Regulation and Consumer Affairs (D) Committee through the Market Analysis Working Group and the Uniformity Working Group: 1) the market analysis handbook, 2) the market conduct annual statement pilot program, 3) uniformity in examination procedures, 4) investigation

standards, and 5) the interstate reciprocity agreement, and 6) collaborative regulatory efforts on specific consumer problems.

**Market analysis handbook.** The purpose of the market analysis handbook is to identify data and other information that is available to regulators and provide guidance on how that data can be used to target the most significant market problems. In addition to helping identify potential problems, the handbook should help states develop a more detailed understanding of the marketplace and target their regulatory resources more efficiently. If used consistently and uniformly by the states, the handbook also should facilitate interstate collaboration by giving states a common baseline of knowledge from which to pursue collaborative actions.

In 2002, the NAIC completed Phase I of the market analysis handbook, compiling a broad range of potential data resources that might be used for market analysis. During 2003, the NAIC is completing Phase II of the market analysis guide, which will focus on how states can use three key data sources to target the most significant market problems: 1) complaint data, 2) relevant financial data and 3) market share information. The working group is currently re-drafting the handbook and will have a revised draft available for comment in June of 2003.

**Market conduct annual statement.** This is a pilot project to determine whether a market conduct annual statement could serve as a market analysis tool that all states could use to review market activity of the entire insurance marketplace in a consistent manner and to identify companies whose practices are outside normal ranges. If the pilot is a success, this will be a tool to help states more effectively target market regulatory efforts. By using common data and analysis, states would have a uniform method of comparing companies' performance not only within their respective states but also across the various states, providing enhanced opportunities for coordinating market regulatory efforts. This increased analysis, targeting and coordination should result in fewer duplicative regulatory efforts. As the statement develops, states should be able to reduce

the number of state-specific data calls and collect data about claims, non-renewals and cancellations, replacement-related activity and complaints on an industry-wide basis.

In the pilot, information will be collected for personal lines, life and annuity products. If a company's performance appears to be unusual as compared to the industry, states will undertake further review of that company. The additional review may range from calling the company for further information to pursuing further analysis to conducting an examination.

In 2002, the nine pilot states (CA, IL, MD, MO, NE, OH, OR, PA and WI) began collecting data from life insurers. Most life data has been received; however, data quality issues are arising. The states participating in the pilot project are now working with the companies and data to make sure the data is accurate and complete. Once completed, the states will begin identifying potential problem companies and discussing the appropriate regulatory responses.

The pilot states also are working with P&C insurers. P&C insurers are required to submit data for the period of January 1, 2003 through June 30, 2003 by Sept. 1, 2003. Assuming there are no data quality issues, the pilot states will complete their analysis of the data by November 1, 2003. During the NAIC 2003 Winter National Meeting, the pilot states will discuss their results for the property and casualty industry, identify common companies of concern and propose coordinated responses where appropriate.

**Uniform exam procedures.** The purpose of this project is to achieve uniformity in exam procedures, so that exams will be more efficient and so that states can rely more on each other's findings. A general outline focusing on the following four areas was developed in 2002: 1) exam scheduling, 2) pre-exam planning, 3) core examination procedures and 4) exam reports. Greater uniformity in exam scheduling will enhance the states' ability to coordinate their exam scheduling in ways that minimize duplication and encourage states to cooperate more. Greater uniformity in pre-exam planning will enhance the states' ability to better target problem areas and provide companies with a clearer

understanding of what is expected of them. The development of uniform examination procedures will make the exam process more predictable and improve exam consistency across states. Finally, greater uniformity in exam reports will allow all audiences, from examiners to consumers, to better understand and compare exam results

Forty of the fifty-five jurisdictions self-certified compliance with two of the four uniform examination areas in 2002. The goal for 2003 is to have at least 40 states certify compliance with all four areas of exam uniformity and develop a process for resolving complaints about certifications. This project also includes implementation of more detailed uniformity standards in key areas, such as use of the Exam Tracking Service (ETS) and standardized data calls.

**Investigation Standards.** In 2002, the NAIC developed a list of resources and guidelines for all of the market regulation areas and found that guidelines were lacking for investigations. At the same time, the NAIC recognized that some market issues could be resolved without the initiation of a market conduct examination. Based upon this, the NAIC is developing investigation standards that will be useful when there are one or two issues to address but there does not appear to be a general business practice or overall business issue to address.

The NAIC is gathering investigation techniques from various states and exploring the distinction between investigations and examinations, and when one or the other is most appropriate.

**Reciprocity agreement.** As work on market analysis, uniform exam procedures, and investigation standards continues, the NAIC also is moving ahead with the broader project of interstate collaboration. This work recognizes that the long term prospects for a more effective and efficient regulatory system depend on more collaboration among the states.

In 2002, five states entered into a reciprocity agreement to prevent duplicative examinations and to share examination information and resources. The member states agreed to forgo routine or “comprehensive” exams performed by another member, but retain the right to conduct an examination of target issues. This concept borrows from financial regulation, where states focus on their domestic insurers and rely on the state of domicile to monitor the financial health of foreign insurers doing business in their state.

The goal for 2003 is to have 15 states sign the reciprocity agreement and better define the baseline responsibilities of the domestic state. Clarity on what is expected of the domestic state is critical to this project, since this will determine the extent to which states can rely on each other. It seems clear that any reciprocity model on the market regulation side will have to allow for targeted action by other states, but the extent to which states will feel compelled to take such targeted action will depend heavily on how effectively baseline responsibilities can be defined and implemented. Those baseline responsibilities are likely to involve a combination of market analysis and examination functions.

**Collaborative action.** While the details of the reciprocity agreement are being hammered out, the NAIC also is moving forward with specific collaborative projects on regulatory problems of common concern to the states. This project is a key priority for the Market Analysis Working Group (MAWG), which serves as a central clearinghouse for discussing and prioritizing common problems. Through the use of MAWG, states will become more proactive in their market regulatory efforts. In addition, the use of MAWG will enhance the coordination of state regulatory efforts and reduce the redundancy of regulatory efforts.

MAWG is in the process of coordinating several regulatory efforts. Because these are formal regulatory efforts, specific company names cannot be released at this time. As the year progresses, MAWG will release as much information as possible in order to explain how certain efforts were modified and better coordinated because of MAWG.

## **Conclusion**

The system of state insurance regulation in the United States has worked well for 125 years. State regulators understand that protecting America's insurance consumers is our first responsibility. We also understand that modernization of state market regulation efforts is needed to ease regulatory compliance for insurers and agents.

We ask Congress and our industry and consumer stakeholders to work with us to implement the NAIC's modernization initiatives through the state system. That is the only practical way to achieve necessary changes quickly in a manner that preserves state consumer protections expected by the public. The state process may take more effort than some would like, but it rewards the citizens and consumers in each state by giving them control over important aspects of insurance and claims procedures that affect their financial security in the communities where they live.

The NAIC and its members have cooperated fully over the years with important inquiries by Congress into the adequacy of the state regulatory system. We believe these inquiries have demonstrated that local and regional state regulation of insurance is the best way to meet the demands of consumers for this unique financial product. We will continue to work with Congress and within state government to improve the national efficiency of state insurance regulation while preserving its longstanding dedication to protecting American consumers.

Thank you for your attention and I'd be happy to answer any questions.

## **APPENDIX A**

### **UPDATE ON NAIC MARKET REGULATION REFORM INITIATIVES**

#### **Consumer Complaint Handling**

Many consumers only contact with a state insurance department will be the consumer services division after the cancellation of an insurance policy or denial of a claim. In 2001, state regulators handled approximately 3.5 million consumer inquiries and complaints regarding the content of their policies or their treatment by insurance companies and agents. This on-going communication with consumers at a local level is one of the many facets that make state insurance regulation so effective and important. In June of 2001, the NAIC adopted the Consumer Complaints White Paper to help ensure consumer assistance was kept at a high level of effectiveness and to enhance this level of assistance where appropriate.

It is also important to recognize states do not process complaints in an isolated manner. Using uniform data codes, states centrally report complaint information to the NAIC's Complaint Database System (CDS), which has been operational since 1991. This system contains over two million complaints and provides a rich source of information to help states better monitor their marketplace, target their resources and respond to consumers. In addition to the CDS, the NAIC's Consumer Information Source (CIS) allows consumers to view a variety of information about insurance companies and to centrally file a complaint against an insurance company or producer. Through these systems, state insurance department are able to maintain local control and oversight with national coordination and cooperation with other states.

#### **Producer Licensing**

In response to the passage of the Gramm-Leach-Bliley Act (GLBA) and the potential creation of the National Association of Registered Agents and Brokers (NARAB), the NAIC focused its attention on satisfying the licensing reciprocity mandates of GLBA. If a majority of states had failed to enact uniform laws and regulations or enact a system of reciprocal licensing by November 12, 2002, NARAB would have been established to provide a mechanism through which uniform licensing, appointment, continuing education and other insurance producer sales qualification requirements and conditions would have been adopted and applied on a multi-state basis. With 36 states certified as having implemented licensing reciprocity as of November 12, 2002, the NAIC exceeded the federal mandates. Today, the number of states certified as having met the licensing reciprocity mandates is 39.

Even though state regulators exceeded the licensing reciprocity mandates, the states continue to view licensing reciprocity as an interim step with the ultimate goal of licensing uniformity. In December of 2002, state insurance departments continued to pursue their commitment to uniform licensing standards by adopting uniform licensing standards for the following areas: 1) licensing qualifications, 2) pre-licensing education

training, 3) producer licensing testing, 4) integrity/personal qualifications/background checks, 5) application for license/license structure, 6) appointment process, 7) continuing education requirements, and 8) limited lines licensing.

Tied to these uniform business standards is the electronic enhancements provided through the NAIC's affiliate, the National Producer Insurance Registry (NIPR). NIPR has helped establish a national Producer Database (PDB). The PDB is a central repository of producer licensing information updated on a timely basis by participating state insurance departments. Information on more than 2.9 million producers can be found on the PDB. In addition to this database, NIPR is helping establish a system of centralized, electronic licensing.

State insurance departments have not only met the federal licensing reciprocity mandates of GLBA, they have exceeded this standard by keeping their promise to pursue uniform licensing standards and the use of electronic technology to make producer licensing more effective and efficient.

### **Rates & Forms**

Insurance is regulated because it is a business that is in essence selling a promise to the public that it will be there in time of need to act on its promises. Since the customer receives an intangible product that requires the utmost trust and good faith, state insurance regulators have traditionally been called upon to monitor the financial performance of insurers and to monitor how insurers treat their policyholders and claimants. An important element of market regulation is the review of rates and policy forms. State insurance regulators have dedicated staff to read insurance contracts to see if they comply with applicable state and federal laws because we know that many consumers do not choose to read their policies until they are ready to submit a claim. If a consumer has a problem with the contract language, it is generally too late once the claim has occurred. States also have staff that are asked to review insurance rating systems to make sure that insurance rates are not excessive, inadequate or unfairly discriminatory and to assure that premiums are reasonable in relationship to the benefits provided.

As insurance has evolved it has become apparent that traditional methods of insurance regulation need to be modernized if the insurance industry is to keep pace with its competitors and if insurance regulators are to adequately serve the interests of insurance consumers. It is the area of insurance regulation known as product compliance that is the subject of the NAIC's Speed to Market Initiative. The Speed to Market Initiative is a voluntary undertaking by state insurance regulators to improve the timeliness and quality of the reviews given to insurer filings of insurance products and their corresponding advertising and rating systems. Insurers have been critical of the time it takes for them to get products to market, in part because they must file many of these products with state insurance regulators. While the filing and review process is an important element of consumer protection, it is incumbent upon states to react to insurer filings in a timely and expedient fashion.



The NAIC's Speed to Market Working Group was formed in March 2000 to evaluate insurer's contentions that the state-based insurance regulatory system places them at a competitive disadvantage with other financial services sectors because it takes too long for insurers to bring new products to market. The task facing the Speed to Market Working Group was to decide how multi-state regulatory processes and procedures might be integrated with individual state regulatory requirements to provide a timely and responsive regulatory environment for insurers and insurance consumers. In order to keep insurers competitive with other financial service entities and allow consumers to purchase beneficial insurance products, this working group was challenged to find an acceptable combination of timely and quality reviews with appropriate consumer protections.

The working group quickly came to realize that not all insurers were unhappy with state-based regulation and that the motivation for change from different parts of the insurance industry often depended upon whether they faced direct competition from financial institutions and securities firms or not. Further, consumer interests were very wary of any change that might be perceived to lessen consumer protections.

To meet the challenges that they faced, the Speed to Market Working Group developed two distinct proposals. In recognition of the distinct efforts that would be required to implement the two separate solutions, the NAIC, in March 2001, divided the Speed to Market Working Group into two separate working groups. The CARFRA Working Group is now charged with oversight of the CARFRA project that will be described later. The Improvements to State-Based Systems Working Group was asked to oversee implementation of the operational and regulatory framework efficiencies that were identified in the Speed to Market Implementation Plan. Before the work on CARFRA are discussed, it is important to be aware of an NAIC initiative that has been developed to provide an electronic system for submission of rate, policy form and advertising materials. The System for Electronic Rate and Form Filing (SERFF) provides a viable electronic alternative for insurers to meet their rate, policy form and advertising materials filings with state insurance regulators.

The SERFF system grew out of discussions that occurred as early as 1993. There was initially a lot of opposition to the system from the insurance industry because of costs and unfounded fears that the system would provide immediate access to competitively sensitive information. A consortium of states and insurers would not let the idea of developing an electronic filing system die. This unlikely alliance was able to hire a software vendor and assemble the rudimentary beginnings of the SERFF system. A year into the development, the SERFF Consortium decided that the project was too labor intensive and time consuming to continue on a completely voluntary basis. The consortium asked the NAIC to take over the infant system in 1997 and guide its further development.

Today the SERFF system is a robust Internet-Based electronic system that is voluntary for both states and insurers. Over 650 insurers participate on the system. Following a push from the Improvements to State-Based Systems Working Group that will be discussed later, there are currently 49 states and the District of Columbia participating in

SERFF. Only Rhode Island has not implemented SERFF, in large part for fiscal reasons. Last year 25,530 filings were processed through SERFF with an average turnaround time of 23 days. More than 57% of the filings were completed with 15 days or less offering true speed to market for the nation's insurers. The NAIC is confident that SERFF offers insurers a way to effectively communicate with insurance regulators in a managed environment that enhances the speed, accuracy and consistency of filing review. The SERFF system will be mentioned in regard to CARFRA and the improvements to state-based systems initiative.

### **CARFRA & The Interstate Compact**

The first proposal is intended to address concerns about direct competition with other financial services sector companies. The Speed to Market Working Group recommended the development of a system featuring a single point of filing and review, national standards for insurance products, and an efficient state-based procedure for processing the filing. The CARFRA Working Group has assumed the development of this single point of filing process.

The Coordinated Advertising, Rate and Form Review Authority (CARFRA) process began in May 2001 with a limited launch that initially focused on life and health products. It is the life insurers that are most directly affected by competition from other sectors providing investment type products. The working group believes that CARFRA can also benefit certain property and casualty products and will expand the process accordingly in the future.

The limited launch of CARFRA meets consumers' needs by speeding new products to market while maintaining appropriate regulatory standards of review. CARFRA gives insurers a single point of entry to submit products for review, with the certainty that a filing can be approved for multiple state use within an established number of days.

CARFRA will not require states to slow down or regress in their current processes. For instance, if a participating state is a file and use state, a CARFRA filing can be used immediately in that state upon filing. CARFRA can accommodate a variety of regulatory approaches, not just prior approval.

The limited launch of CARFRA began its part of the regulatory re-engineering process on May 1, 2001. Starting with a focus on life and health products, the limited launch allows insurers to make one filing that will be reviewed based on a set of national standards, together with certifications to state deviations, and receive action from each participating state within 45 days of filing. Future plans call for a 30-day turnaround time.

To date CARFRA has provided valuable information to regulators and insurers. While, it has not been successful from a filing volume standpoint, insurance regulators know that a cooperative review process can work. Due diligence to discover why more insurers have not chosen to use CARFRA led to the conclusion that the state law variations was the most significant stumbling block. Regulators now believe there is a way to develop a more efficient review process for life insurance and annuity products—one that will help

insurers better compete in the marketplace while maintaining a high level of protection for insurance consumers. Regulators feel that the best way to accomplish this is through the creation of an interstate compact. In March 2002, the NAIC established the Interstate Compact Working Group to accomplish this goal—to create a national, state-based system of insurance regulation that would provide for uniform standards and a single point of filing for several lines of insurance. The working group drafted a proposed interstate compact will have the flexibility to include life insurance, annuities, disability income and possibly long-term care products. This compact is now known as the Interstate Insurance Product Regulation Compact and this will replace the CARFRA Project once it is implemented.

The work on the drafting of the interstate compact is complete, however, the hard work on implementation has just begun. The NAIC recognizes that a broad base of support is critical. State insurance regulators have been working extensively with their legislative counterparts at the National Conference of State Legislators (NCSL) and the National Conference of Insurance Legislators (NCOIL) to make the compact proposal a reality. In addition, another NAIC working group has been appointed to work on national standards for the compact. This work is underway and preliminary recommendations on a few products are expected to be announced in June 2003.

The second proposal was initially developed by the Improvements to State-Based Systems Working Group. They and focused on operational efficiencies and regulatory framework improvements that can be made to current state-based regulatory systems for product review. It is this working group that developed and adopted a streamlined model rating law urging states to relax filing requirements for commercial lines insurance products. In addition the working group has accomplished many successes since its formation. Included are:

§ Finished the Review Standards Checklist formats for both Property and Casualty and Life and Health product filings. These have now been adopted in 44 states providing insurers with streamlined access to filing requirements thereby improving speed to market for those insurers that choose to use them.

§ Developed the Product Requirements Locator for property and casualty products that will allow insurance companies to query a searchable database by product, requirement, or by state to determine what each state requires when developing a product. Twelve states have implemented this feature with another ten working on adding their product filing requirements. Work on a comparable product locator for life insurance and health insurance products is underway.

§ Completed the work on Uniform Product Coding for both property and casualty and life and health. This allows companies to use common product names and codes for filings in all states.

§ Developed the uniform transmittal forms for product filings for both property and casualty and life and health. This will eliminate companies having to use different transmittal forms when making multi-state filings.

§ Developed measurement tools for determining turnaround time on filings.

§ Implemented numerous enhancements to the System for Electronic Rate and Form Filings (SERFF), including Electronic Funds Transfer (EFT), enhanced navigation and search features, and the ability to track paper filings and metrics.

## **Market Analysis**

Market analysis can provide important tools for monitoring the broader marketplace so that problems can be identified and addressed at an early stage and exam resources can be targeted on the most serious problems. Market analysis tools could include everything from simple surveys on high priority issues to market conduct annual statements, analogous to the financial annual statement that is a bedrock of financial regulation. All states currently engage in at least some types of market analysis, if only to address pressing problems and choose companies for examination. At the most rigorous level, a market analysis program could provide states with the tools to: 1) consolidate data sources into one central system, 2) establish industry-wide benchmarks, and 3) systematically identify problem companies falling outside established benchmarks. At a simpler level, market analysis could provide all states with some rudimentary tools, such as complaint trending analysis that some states already use effectively to identify and address the most serious problems in their marketplace. Throughout 2002, the NAIC further refined the goals of market analysis by focusing on the following two projects: 1) a market analysis handbook and 2) a market conduct annual statement.

The purpose of the Market Analysis Handbook is to identify data and information that is already available to regulators and compile ways this data can be used. This data and information, if used correctly and uniformly, can assist states in identifying possible predictors of potential problems, assist states in using their resources better, and assist states in developing a more detailed understanding of the marketplace. In 2002, the NAIC completed Phase I of the market analysis handbook, which lists potential data resources that might be used for market analysis. During 2003, the NAIC is moving into Phase II of the market analysis guide, which will focus on how states may use the following three sources of data to target the most significant market problems: 1) complaint data, 2) relevant financial data and 3) market share information. The working group is currently re-drafting the handbook and will have a revised draft available for comment in June of 2003.

The annual statement is a market analysis tool that all states can use to review market activity of the entire insurance marketplace in a consistent manner and to identify companies whose practices are outside normal ranges. This will be a tool to help states more effectively target market conduct exams. By using common data and analysis, states will have a uniform method of comparing companies' performance not only within their respective states but also across the various states, providing enhanced opportunities for coordinating market conduct exams. This increased analysis, targeting and coordination will result in fewer duplicative exams. As the statement develops, states may be able to reduce the number of state-specific data calls. States will collect data about claims, non-renewals and cancellations, replacement-related activity and complaints on an industry-wide basis. The information will be collected for personal lines, life and annuity products. If a company's performance appears to be unusual as compared to the industry, the state

will want to undertake further review of that company. The additional review may be as simple as calling the company for further information or clarification or conducting further analysis.

In 2002, the pilot states began collecting data from life insurers. Most life data has been received; however, data quality issues are arising. The states participating in the pilot project are now working with the companies and data to make sure the data is accurate and complete. Once completed, the states will begin identifying potential problem companies and discussing the appropriate regulatory responses. The pilot states will also begin working with P&C insurers. P&C insurers are required to submit data for the period of January 1, 2003 through June 30, 2003 by Sept. 1, 2003. Assuming there are no data quality issues, the pilot states will complete their analysis of the data by November 1, 2003. During the NAIC 2003 Winter National Meeting, the pilot states will discuss their results for the property and casualty industry, identify common companies of concern and propose coordinated responses where appropriate.

As the market analysis process is further refined and formalized, the NAIC's Market Analysis Working Group (MAWG), analogous to the Financial Analysis Working Group, will serve as a central clearing point for the prioritization and resolution of issues. Through the use of MAWG, states will become more proactive in their market regulatory efforts. In addition, the use of MAWG will enhance the coordination of state regulatory efforts and reduce the redundancy of regulatory efforts.

### **Market Conduct Examinations**

A market conduct examination is conducted to: 1) ensure equitable treatment of policyholders; 2) determine compliance with the statutes and regulations of a state; and 3) actively monitor the insurance marketplace. While serving a general purpose of monitoring the insurance industry in a state, market conduct examinations also serve as a preventative measure by identifying areas where an insurer should make improvements. Poor market practices and poor management may eventually lead to the financial insolvency of an insurer. Market conduct examinations also serve to verify policyholders and beneficiaries receive the full benefits from the contracts into which they have entered. Through the process of a market conduct examination, an insurance department is able to identify potential problem areas as soon as possible in order to protect the consumers of the state. Initially, each state must thoroughly assess and analyze its market and then attempt to dedicate adequate resources to the market conduct examination process. As regional markets differ, so must the approach to the examination process.

In March of 2003, the NAIC adopted the Market Conduct Examination Resource Guidelines to provide states with various suggestions they may wish to consider after a market assessment has been conducted. This document is divided into the following four sections: 1) description of the market conduct examination function, 2) laws and regulations that support the market conduct examination function, 3) computer and other technical resources that support the market conduct examination function, and 4) areas of expertise and other personnel resources that support the market conduct examination function.

In addition to addressing market conduct examination resources in 2002, the NAIC developed a uniform market conduct examination outline focusing on the following four areas: 1) exam scheduling, 2) pre-exam planning, 3) core examination procedures and 4) exam reports. Greater uniformity in exam scheduling will enhance the states' ability to coordinate their exam scheduling in ways that minimize duplication and encourage states to cooperate more. Greater uniformity in pre-exam planning will enhance the states' ability to better target problem areas and provide companies with a clearer understanding of what is expected of them. The development of uniform examination procedures will make the exam process more predictable and improve exam consistency across states. Finally, greater uniformity in exam reports will allow all audiences, from examiners to consumers, to better understand and compare exam results. Forty of the fifty-five jurisdictions have self-certified compliance with two of the four uniform examination areas in 2002. The states are continuing to work on implementing the uniform examination standards.

Greater uniformity should enhance the states' ability to participate in collaborative regulatory efforts. In 2002, five states entered into a Reciprocity Agreement to prevent duplicative examinations and to share examination information and resources. The member states agreed to forgo routine or "comprehensive" exams performed by another member, but retained the right to conduct an examination of target issues. This concept borrows from financial regulation, where states focus on their domestic insurers and rely on the state of domicile to monitor the financial health of foreign insurers doing business in their state. The NAIC continues to work with states to become a part of the reciprocity agreement by improving the states' ability to consider other state regulatory activities, while retaining their own ability to regulate. A key issue to be resolved is determining what the "baseline" monitoring or examination responsibilities should be for the domestic regulator.

The NAIC's Exam Tracking System (ETS) is used to facilitate automated examination calls and provide centralized examination results. This system has been operational since 1985 and contains information for both current and closed financial, market conduct and combined examinations.

In 2002, the NAIC modified ETS to provide a better tool for examination coordination and uniformity efforts. Phase I modifications, which consisted of more automated methods of calling examinations and ensuring the ETS features were tied to the NAIC *Market Conduct Examiners Handbook*, were released in January of 2003. Additionally, four Personal Information Capture System (PICS) reports were created to notify examiners of specific company examinations when they are input into the system. Phase II will consist of the following changes: 1) the market findings screen will be modified to correlate with the handbook, 2) development of market jumpstart reports, and 3) generation of group historical data reports. Phase II is scheduled for release in May of 2003.

## **Investigations**

In 2002, the NAIC developed a list of resources and guidelines for all of the market regulation areas and found that guidelines were lacking for investigations. At the same time, the NAIC recognized that some market issues could be resolved without the initiation of a market conduct examination. Based upon this, the NAIC is developing more defined investigation standards that will be useful when there are one or two issues to address, but there does not appear to be a general business practice or overall business issue to address. The NAIC is gathering investigation techniques from various states and exploring the distinction between investigations and examinations.

## **Enforcement**

The uniform market conduct examination outline directs states to devise an enforcement strategy. Pursuant to the outline, an enforcement strategy should differentiate between willful actions and inadvertent ones and consider appropriate administrative resolutions, which could be financial or non-financial. States should also consider a methodology for determining the amounts of fines, based on a host of criteria, including the size of the company, the market share, whether the problems have been corrected, and any host of mitigating or aggravating circumstances. States should also be certain to communicate the basis of any assessed penalty. Beyond this outline, the Market Analysis Working Group is developing enforcement guidelines for regulatory actions that might be coordinated by this working group.